

The Economic Crisis: *Is there a Middle Ground? II*

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Major points

- (1) Problem: Massive debt in all sectors
- (2) Cause: Bank de-regs in 1999, overleveraged
 - Same as in the depression
 - Additional factors including energy
- (3) Consequences: Stagnant eco lasting 10 yrs or more
 - Until heavy debt is paid down
 - Another recession near by
 - Unemployment lingering
 - Political melt down

#1: How We Got Here: Financial Mismanagement & Meltdown

Financial Crisis Commission, January 2011

1. Failure by two administrations
2. Corporate mismanagement
3. Heedless risks by Wall Street
 - \$40 in assets, \$1 in capital
 - Shoddy mortgage lending
4. Failure in government regulations
 - Failed capital restrictions

Banking Industry Leverage Example

Total invest	% down	Bank Invest	Indiv invest	Bank Profit(1%)
1. \$200,000	50%	\$100,000	\$100,000	\$2,000
2. \$400,000	25%	\$300,000	\$100,000	\$4,000
3. \$1,000,000	10%	\$900,000	\$100,000	\$10,000
4. \$2,000,000	5%	\$1,900,000	\$100,000	\$20,000
5. \$5,000,000	2%	\$4,900,000	\$100,000	\$50,000
6. \$10,000,000	1%	\$9,900,000	\$100,000	\$100,000



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“Have Done Little to Prevent a Repeat of These Events in Near Future”

– *Thomas Hoenig, President, KC Federal Reserve Bank, Summer 2011*

Year	Commercial Banks	Largest	Control Assets
1913	21,000	5	2.5%
1980	14,000	5	14.0%
2010	7,000	5	60.0%
		20	86.0%

Several of the 20 largest nearly brought the economy down

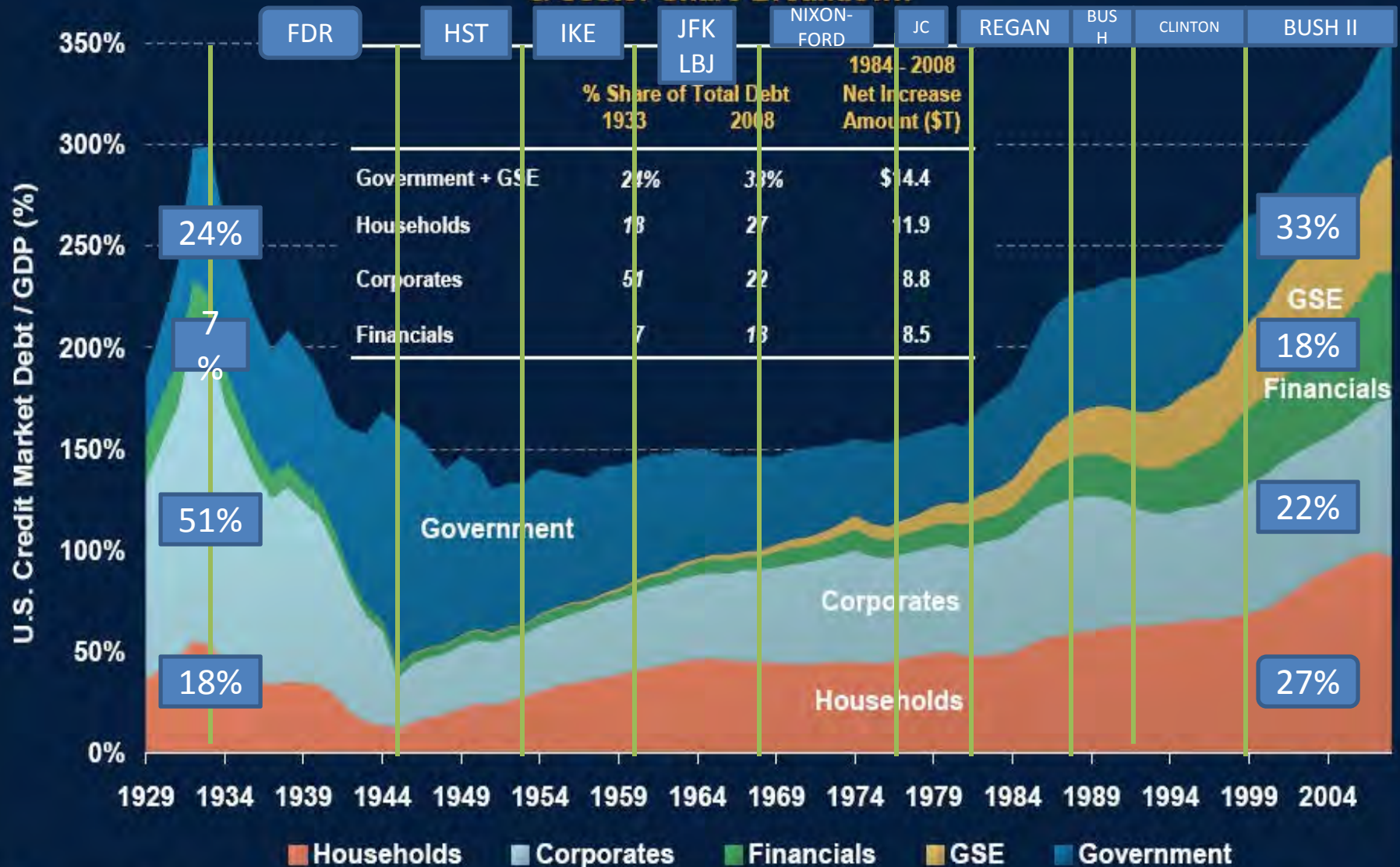
#2. How Bad Is It?: Total Market Credit Debt

380% of GDP in 2009 (\$52.3 trillion)



Figure 1: This chart compares total debt (or "credit") in the U.S. to GDP (or Gross Domestic Product) on percentage basis. Current total credit-market debt stands at more than 340 percent of total GDP.

U.S. Total Credit Market Debt as % of GDP, 1929 – 2008 & Sector Share Breakdown



Morgan Stanley

Note: GSE (Government Sponsored Enterprises) debt includes various agency-backed mortgages; Source: Federal Reserve, Ben Wattenberg, *The Statistical History of the United States, From Colonial Times to the Present*, Morgan Stanley Research.

Level of Debt: Dominant Factor

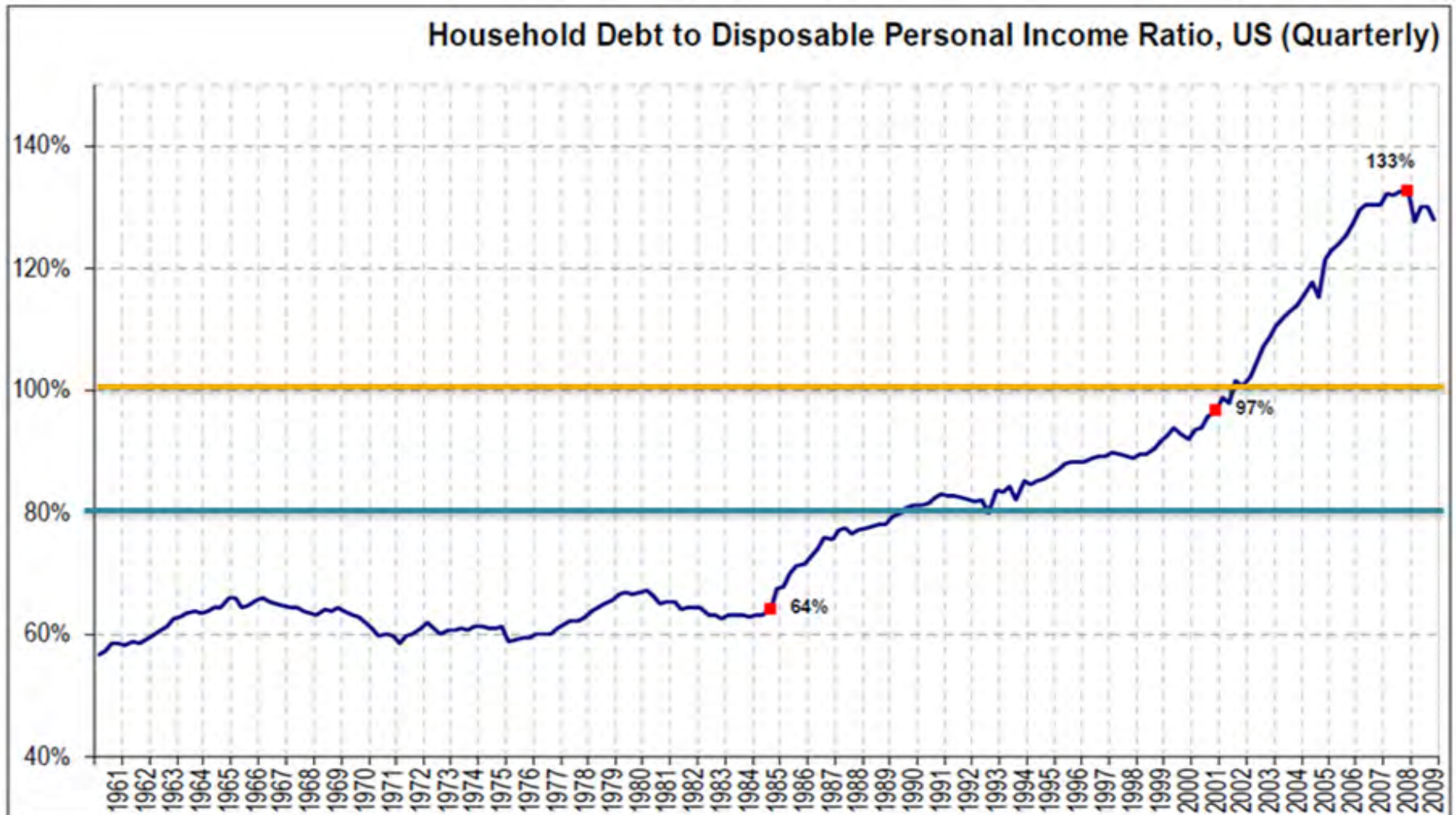
Substantial Debt in all 4 Sectors of Economy

- Household Debt ----- Demand Side
- Corporate Debt ----- Supply Side
- Financial Debt ---- Loans and Services
- Government Debt ----- Services & Regs

No turn-around likely until paid down substantially – but at what level?

How Long Will it Last? Drop 50%?

“Consumer is Not Doing Very Well”



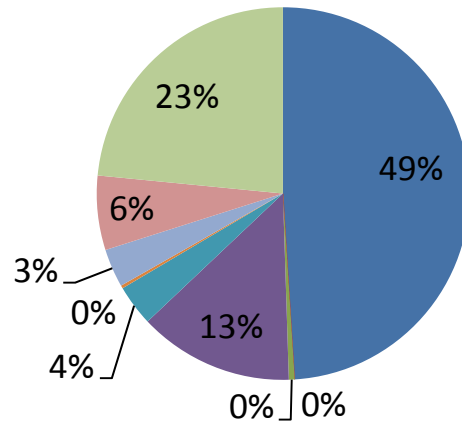
#3: Other Contributing Factors: What is the Government doing now?

- **Trouble Assets Relief Program (TARP):** \$700 billion authorized
- **Stimulus:** \$787 billion (6% of GDP)
- **\$440 billion government bailout (\$425 recovered)**
- **Feds printing \$\$\$\$\$\$ (1.5 trillion)**
- **Federal Reserve:** low interest
- **Stalemate in D.C. –** taxes and government spending

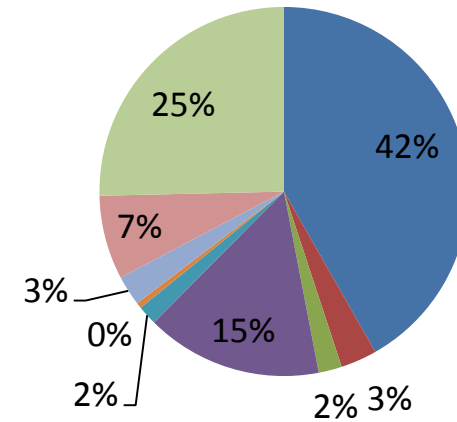
Government Expenditures

- National Defense
- Medicare
- Health care services (Medicaid?)
- Social security
- Unemployment compensation
- Food and nutrition assistance
- Agriculture
- Net Interest
- Other Expenditures

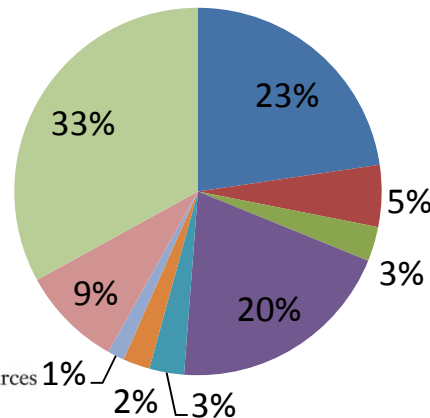
1962



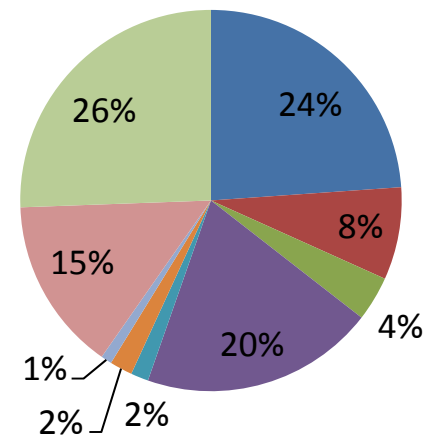
1970



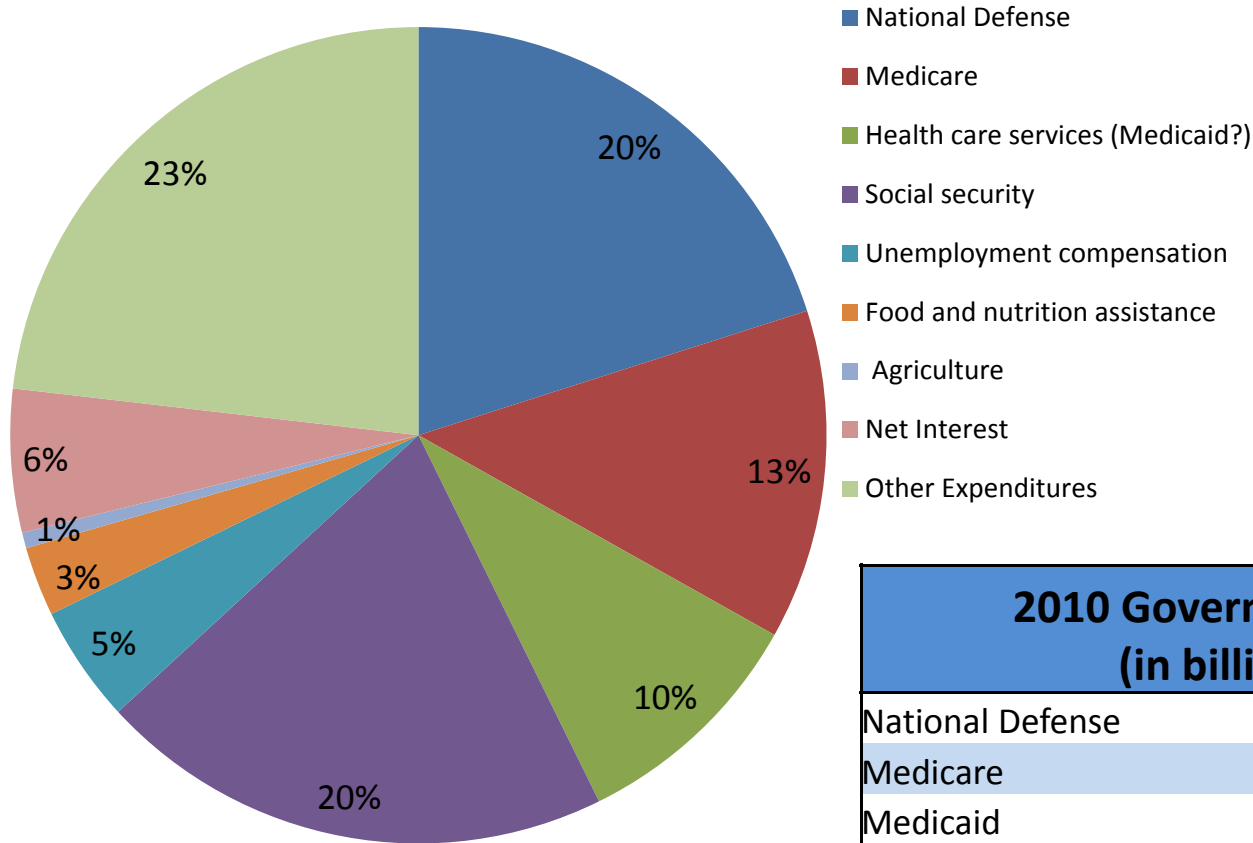
1980



1990



2010 Government Expenditures



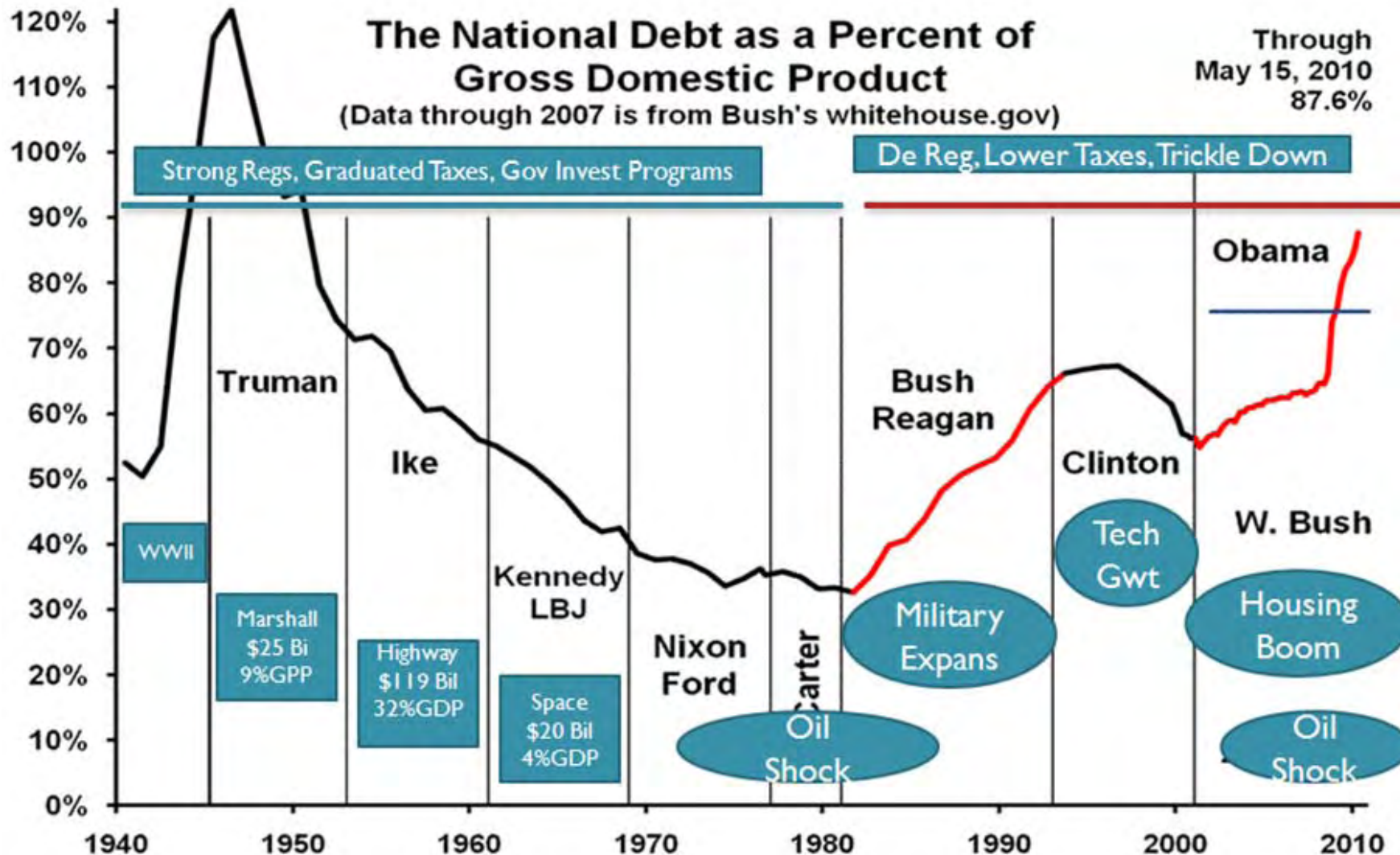
2010 Government Expenditures (in billions of dollars)		
National Defense	693.586	20%
Medicare	451.636	13%
Medicaid	330.71	10%
Social Security	706.737	20% 63%
Net Interest	196.194	6% 69%
Unemployment	160.145	5%
Nutrition Assistance	95.11	3%
Agriculture	21.356	1%
Other Expenditures	800.739	23%
Total Outlays	3456.213	
Nominal GDP	14,657.8	24%

Health cost for growing older

- Knee Surgery \$4,500
- Knee Replacement \$45,000
- Hip Replacement \$39,000
- Open Heart Surgery \$100,000-\$200,000
- *Assisted Living \$2,000-\$4,000 Mth

What has the Government done in the past?

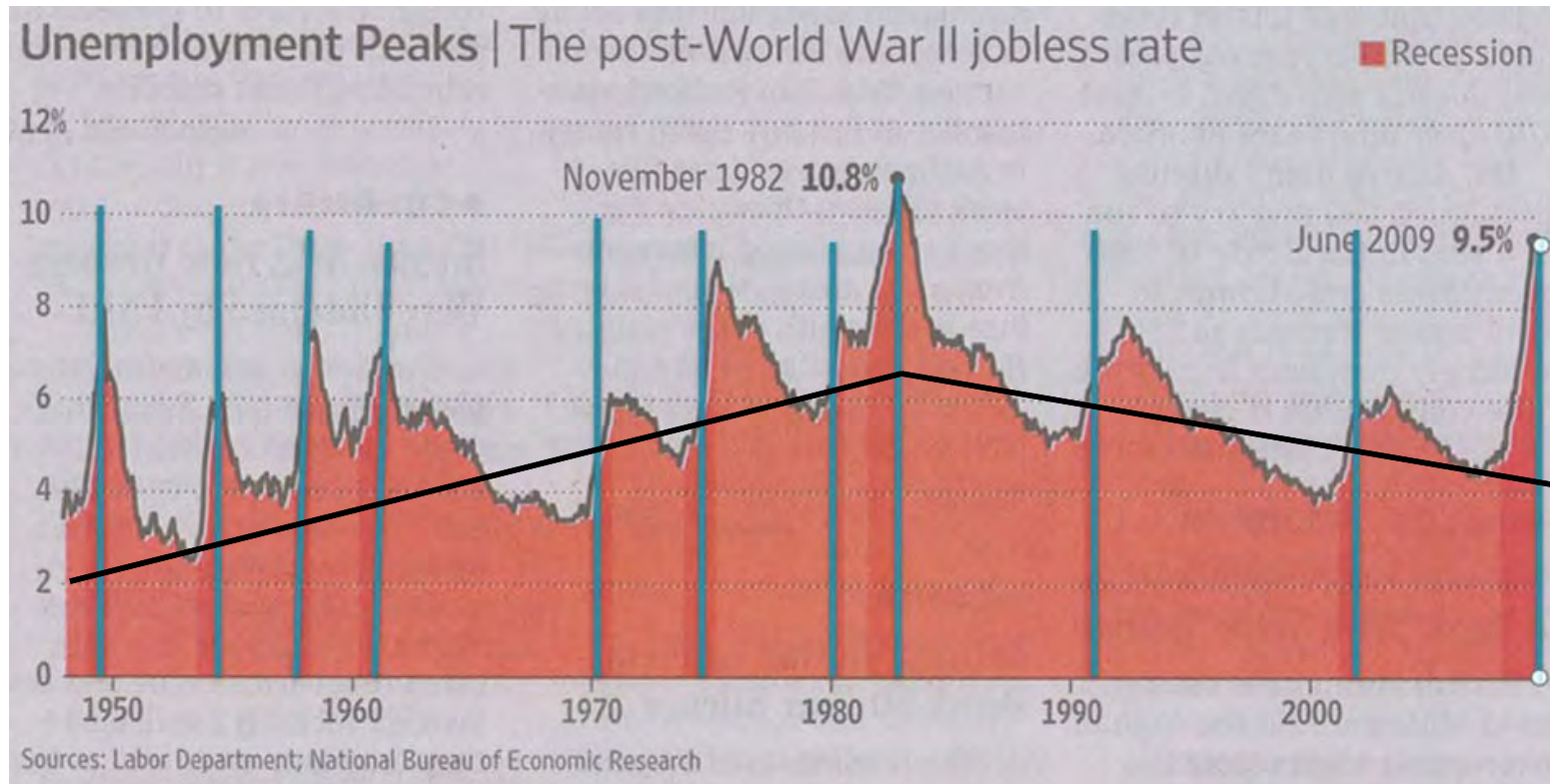
White House Data on Gross National Debt



Top 20 Countries by GDP

Rank	Country	GDP (millions of USD)
—	World	62,220,000
—	European Union	15,900,000
1	United States	14,620,000
2	China	5,745,000
3	Japan	5,391,000
4	Germany	3,306,000
5	France	2,555,000
6	United Kingdom	2,259,000
7	Italy	2,037,000
8	Brazil	2,024,000
9	Canada	1,564,000
10	Russia	1,477,000
11	India	1,430,000
12	Spain	1,375,000
13	Australia	1,220,000
14	Mexico	1,004,000
15	South Korea	986,300
16	Netherlands	770,300
17	Turkey	729,100
18	Indonesia	695,100
19	Switzerland	522,400
20	Belgium	461,300

**2010 10% Unemployment (15 million)
+ 7.5% part time and marginal (27 million)**



#4: Other Contributing Factors: Divergence of Wealth and Income

- **Economy Turns on Consumer Spending-70% of Eco Activity**
- **Top 1% have 35% of wealth, gained 15% since 1980**
- **Top 10% have 48% of income, gained 13% since 1980**

Warren Buffett “ A minimum tax for the wealthy” NYT, 11/26/12

- In 1992 highest federal and payroll tax paid by 400 highest incomes in the US : Avg income, \$202 mil/yr or \$97,000 per hr for a 40 hr week

¼ paid 15%

½ paid 20%

many paid 0%

Change tax law: (\$1 to \$10 mil pay 30%)

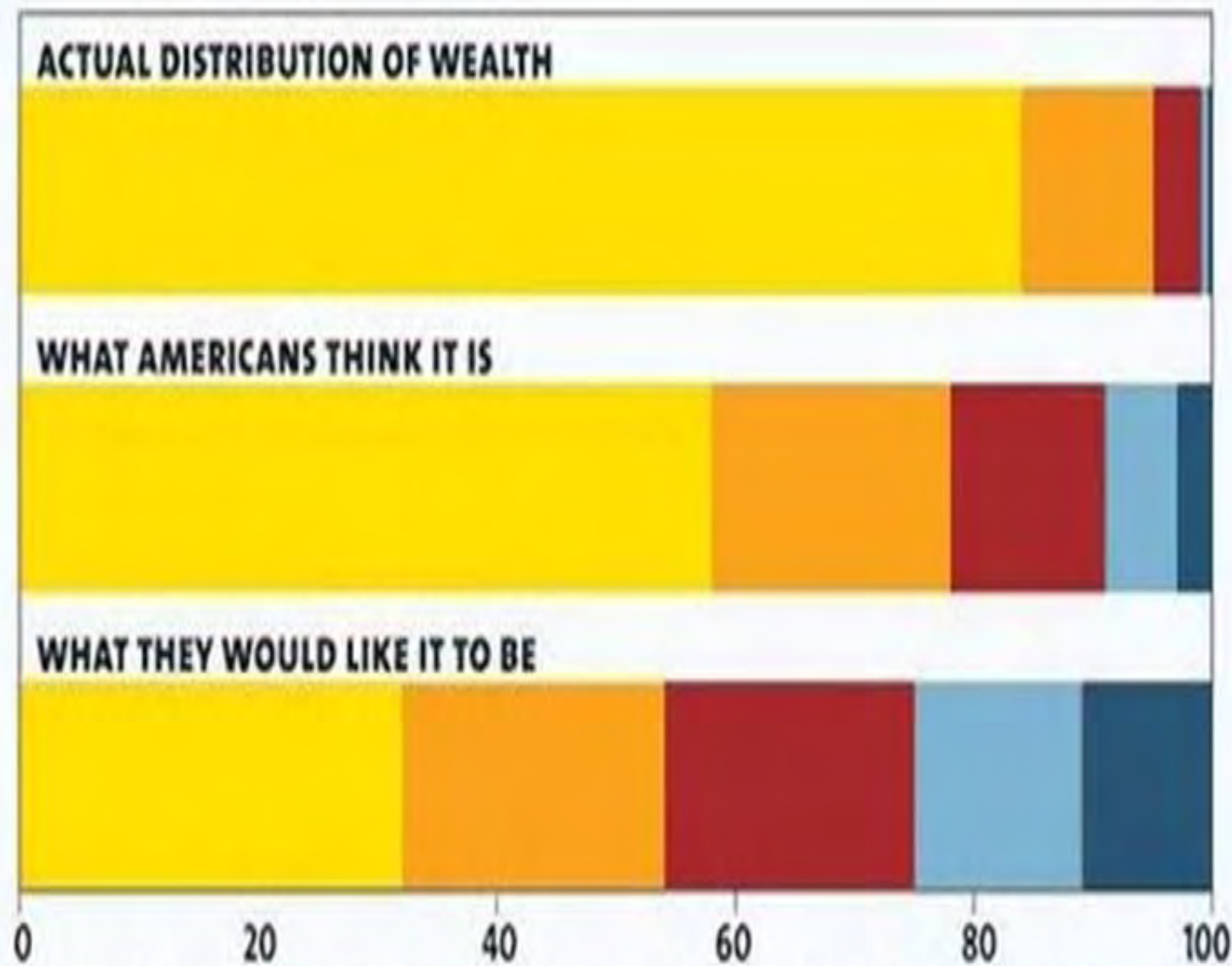
(Greater than \$ 10 mil pay 35%)

(Limit raised from \$250k to \$500k)



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Source: Michael I. Norton, Harvard Business School; Dan Ariely, Duke University

#5: Other Contributing Factors- Macro's

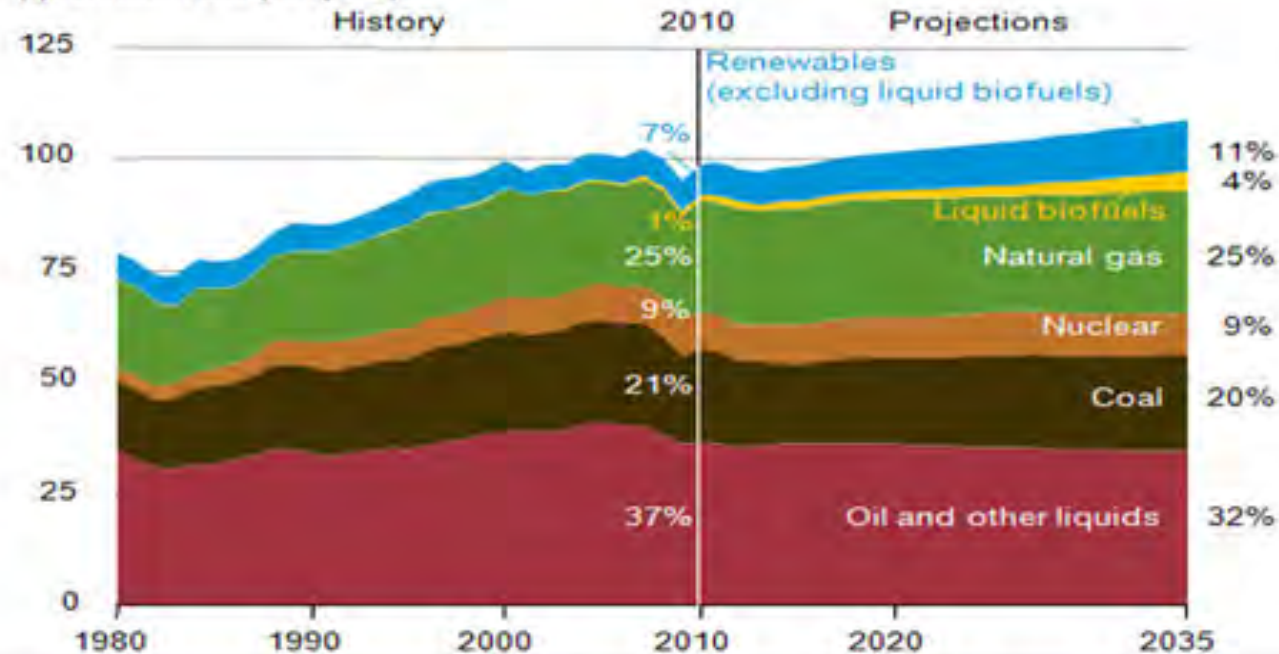
- Interest rate (+’s, -’s)
- Exchange rate (+’s, -’s)
- Energy – high crude oil prices
- Global labor competition,
declining manufacturing sector
- Exchange rate with China

#6: Other Contributing Factors- Energy

U.S. energy use projected to grow slowly and become 1 carbon-intensive >

Figure 8. U.S. primary energy consumption by fuel, 1980-2035

(quadrillion Btu per year)



Source: U.S. Energy Information Administration, *Annual Energy Outlook 2012 (Early Release)*, January 23, 2012

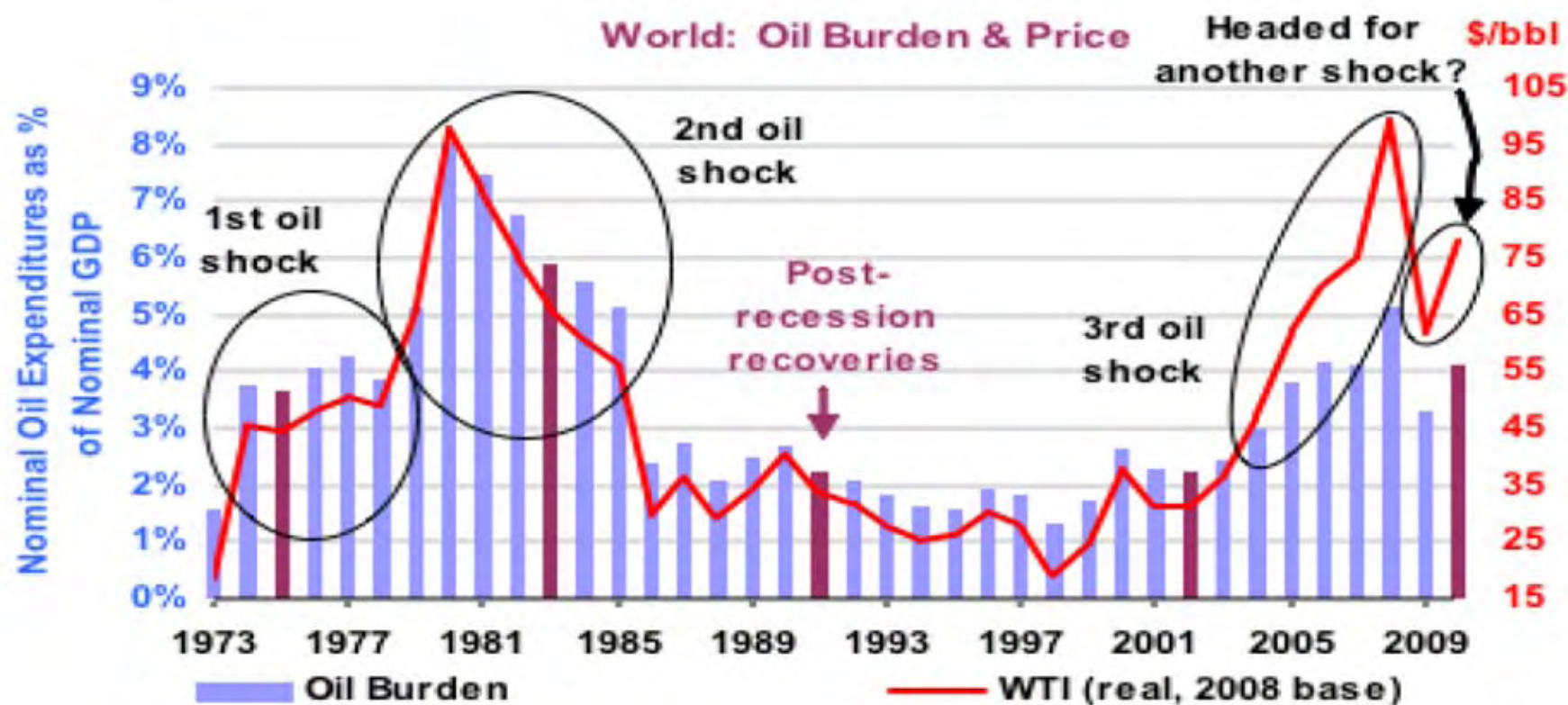


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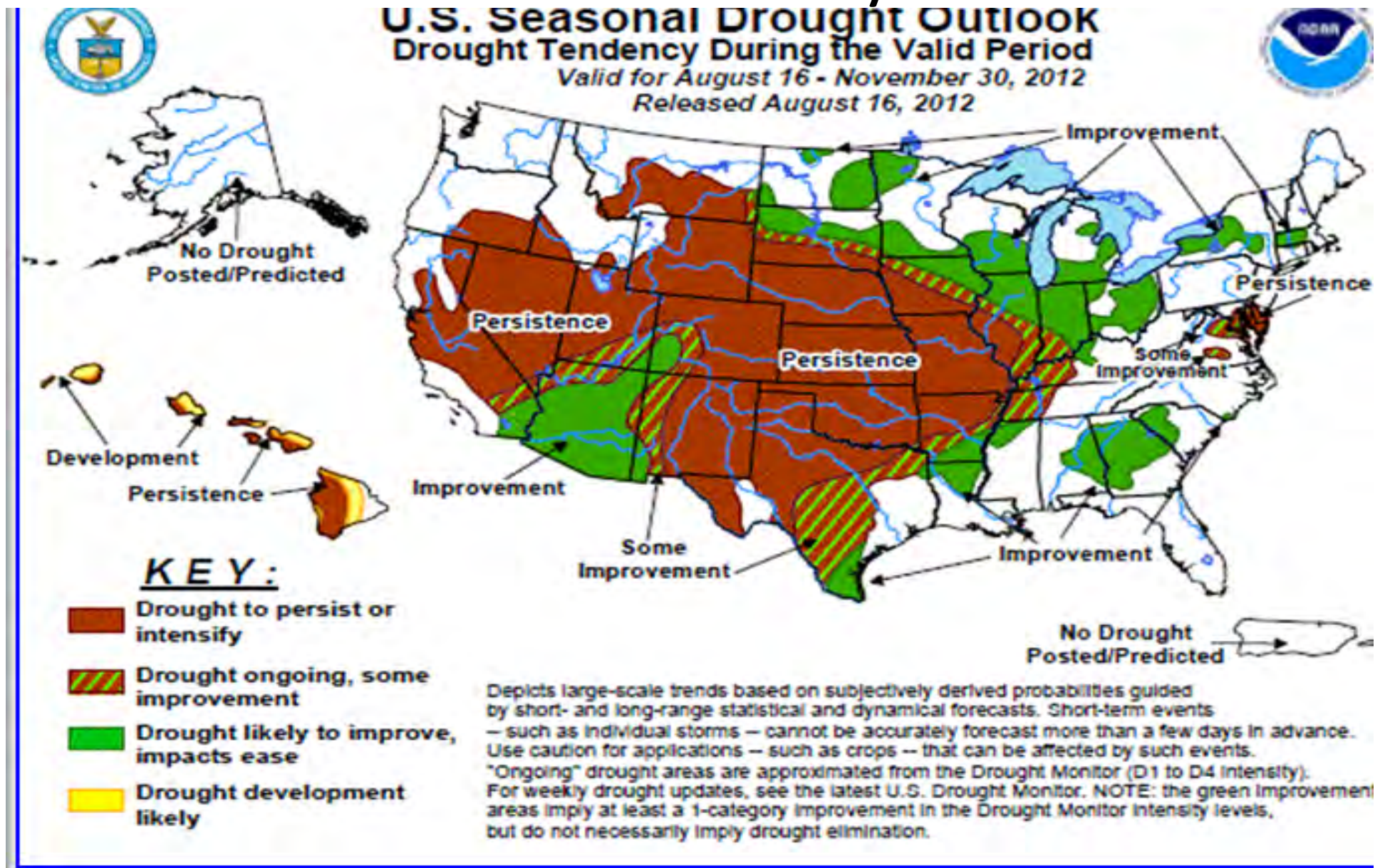
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Possible Economic Trouble Ahead if Recent Price Gains are Sustained

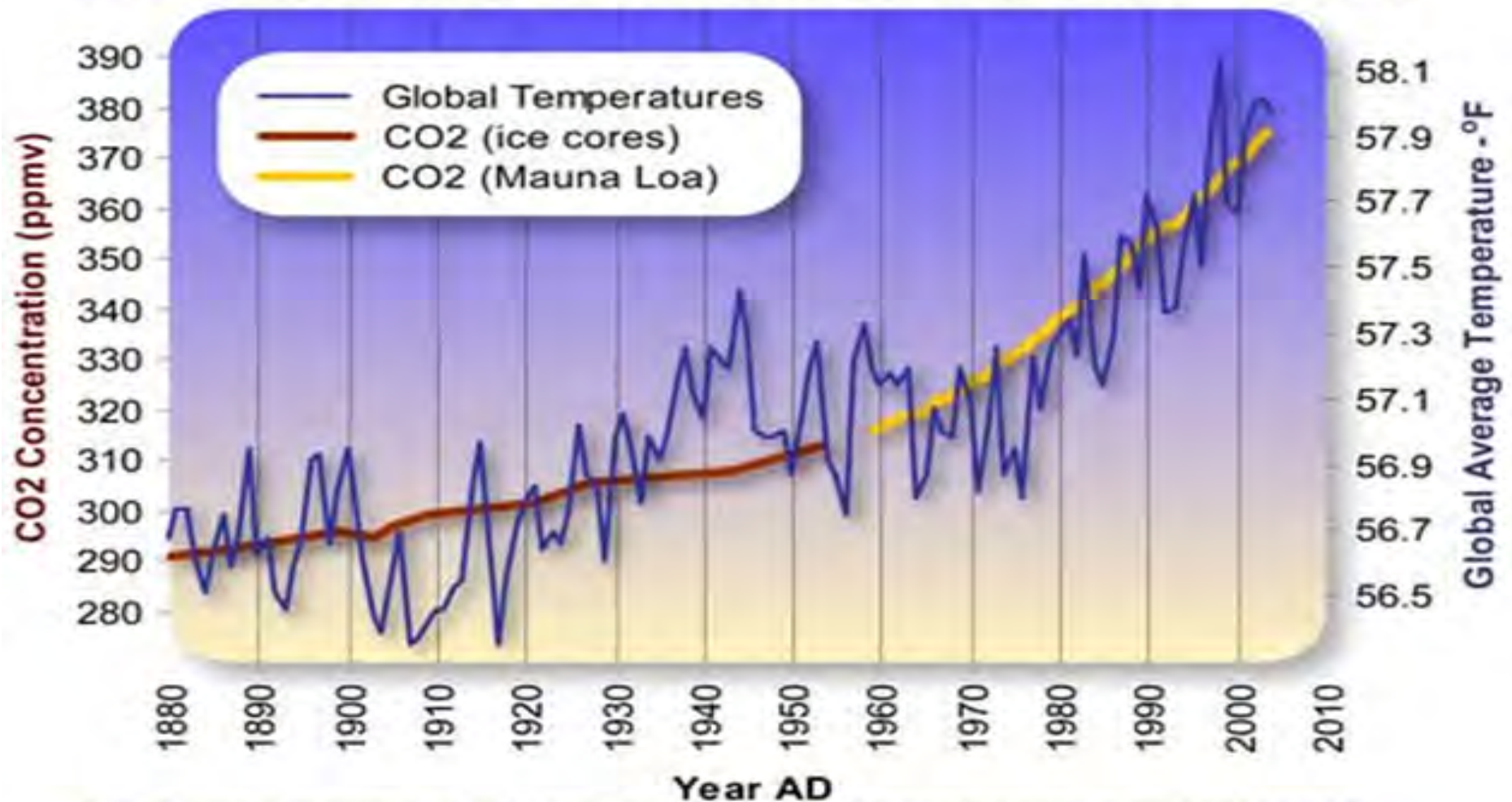
Testimony on the energy and oil market outlook for the 112th Congress, Richard H. Jones, Deputy Executive Director of the International Energy Agency, Feb. 3, 2011, Washington, D.C.



#7. Other Contributing Factors-Global Weather –last 3 years



Global Average Temperature and Carbon Dioxide Concentrations, 1880 - 2004



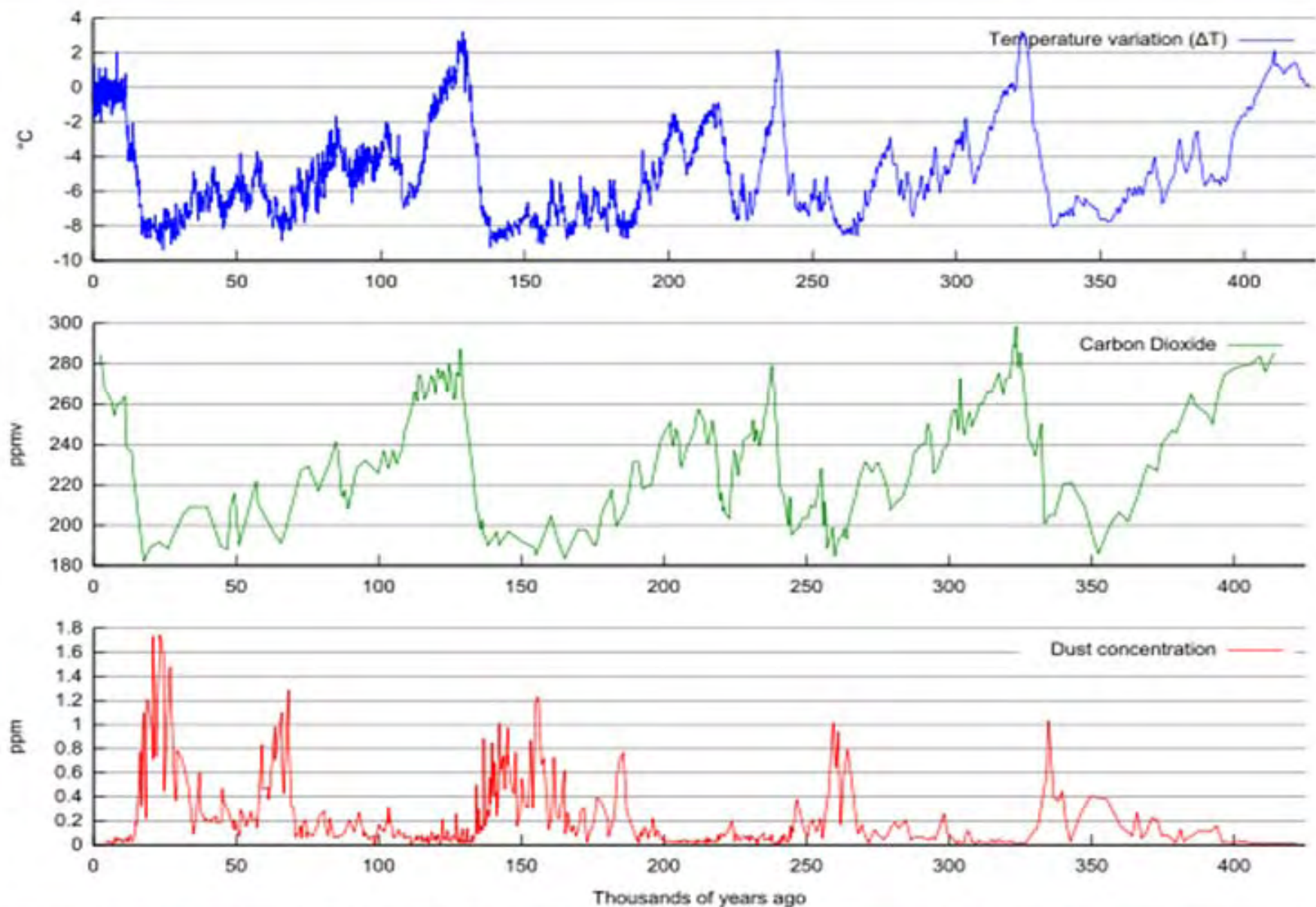
Data Source Temperature: ftp://ftp.ncdc.noaa.gov/pub/data/anomalies/annual_land_and_ocean.ts

Data Source CO2 (Siple Ice Cores): <http://cdiac.esd.ornl.gov/ftp/trends/co2/siple2.013>

Data Source CO2 (Mauna Loa): <http://cdiac.esd.ornl.gov/ftp/trends/co2/maunaloa.co2>

Graphic Design: Michael Ernst, The Woods Hole Research Center





Ice core data for the past 400,000 years. Note length of glacial cycles averages ~100,000 years. Blue curve is temperature, green curve is CO₂, and red curve is windblown glacial dust (loess). Today's date is on the left side of the graph.

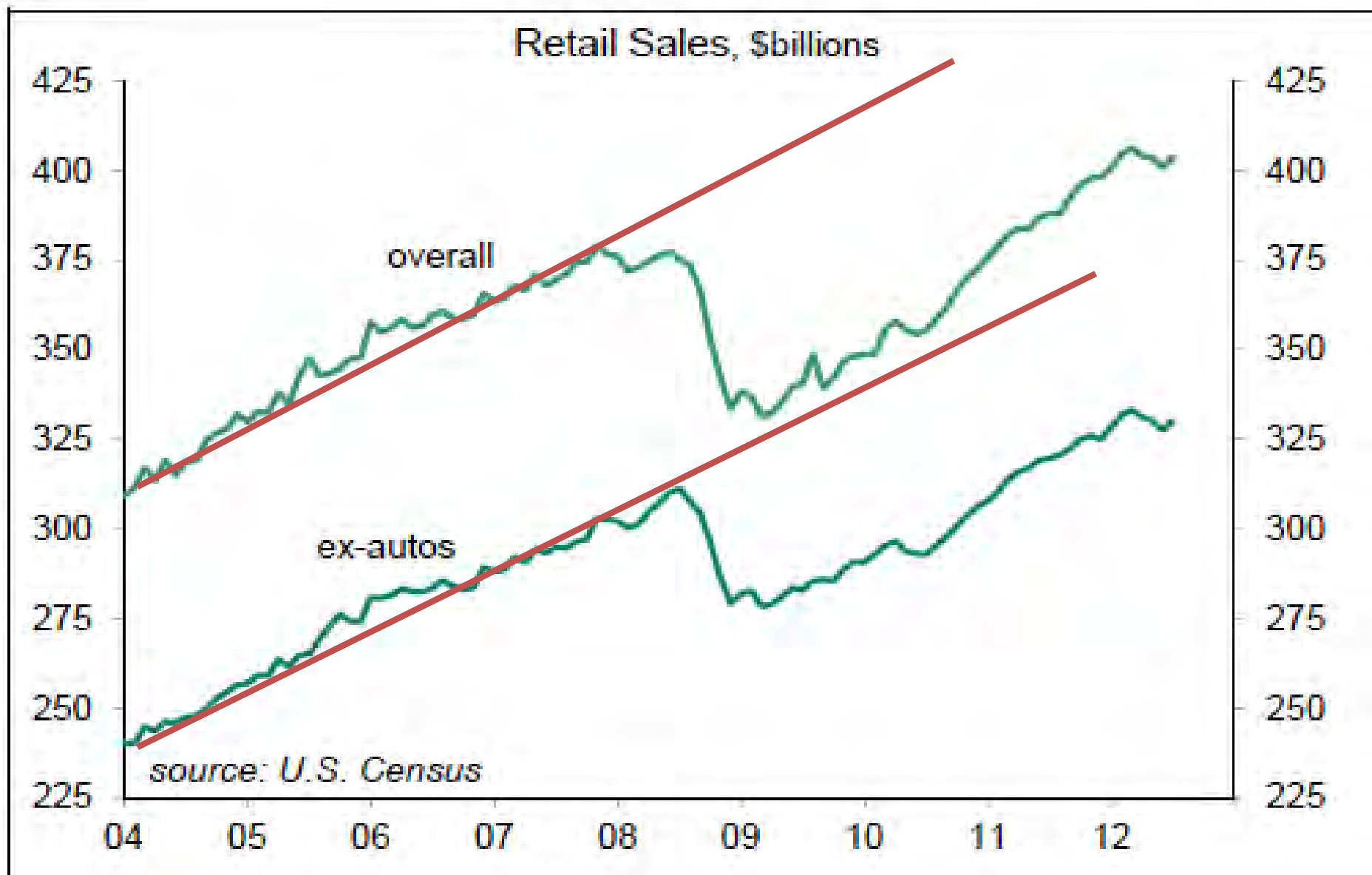
#8: Other Contributing Factors--Political Meltdown

1930s-1979

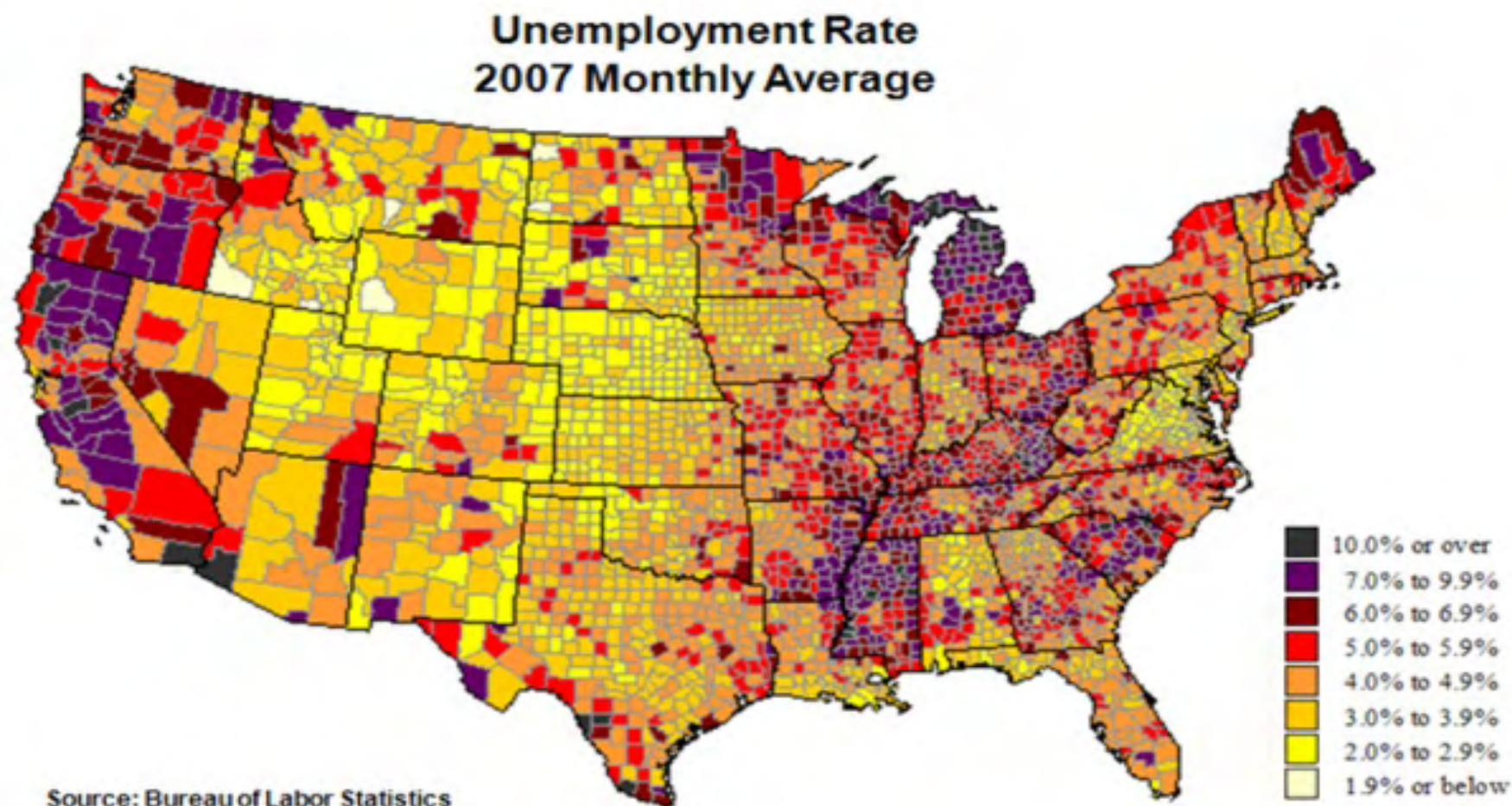
- Keynesian – Counter Cyclical Approach
- TIGHT lending
- Glass Steagall Act
- Graduated taxes
- Strong labor unions
- Social programs – Medicare, Medicaid
- Structural investment programs – more govnmt
- 3 major wars

1980-current

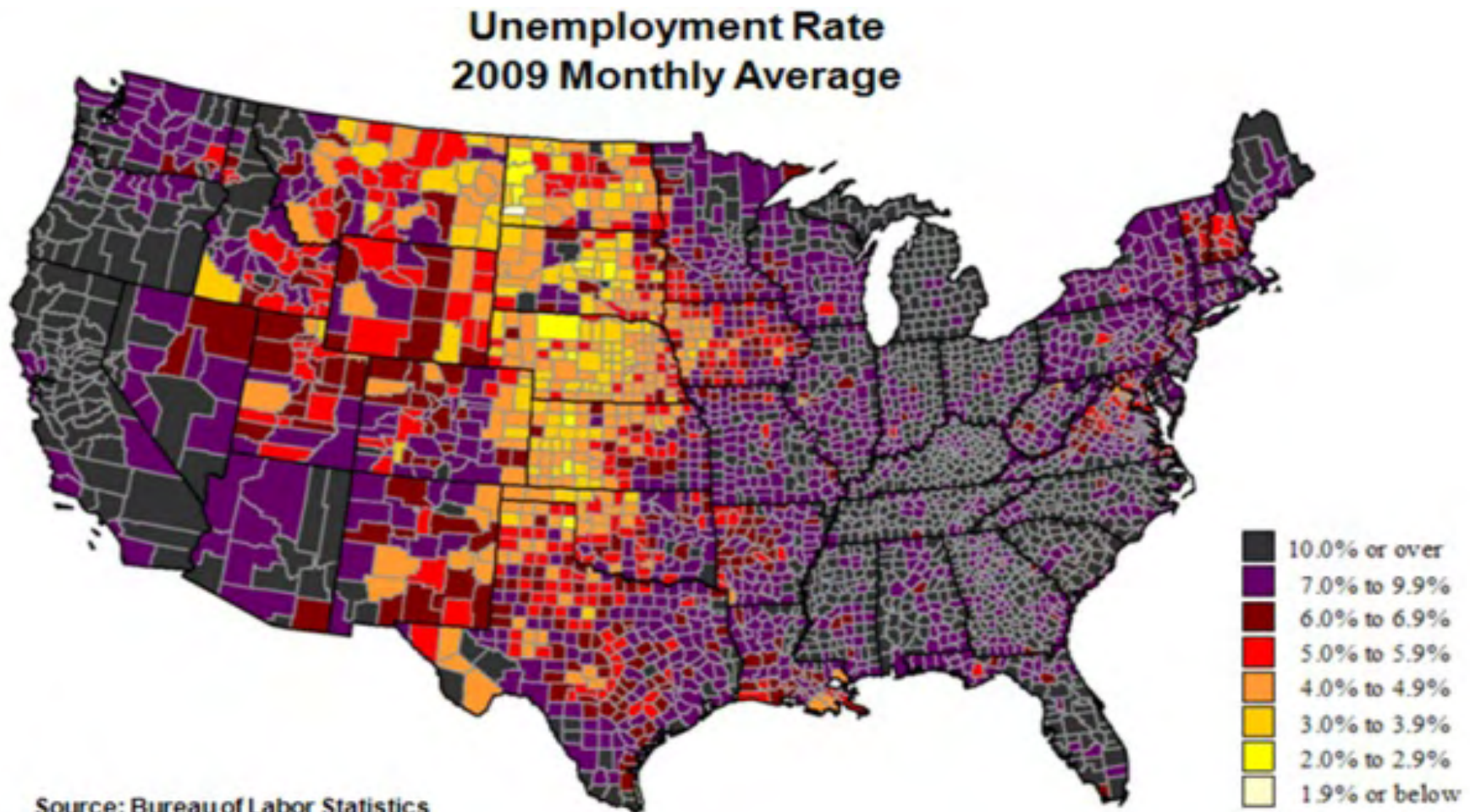
- Supply side – Market approach; trickle down
- LENIENT lending
- Repealed Glass Steagall
- Lowered taxes
- Weaker labor unions
- Social programs – Added Health Care
- Less government – more market signals
- 2 major wars



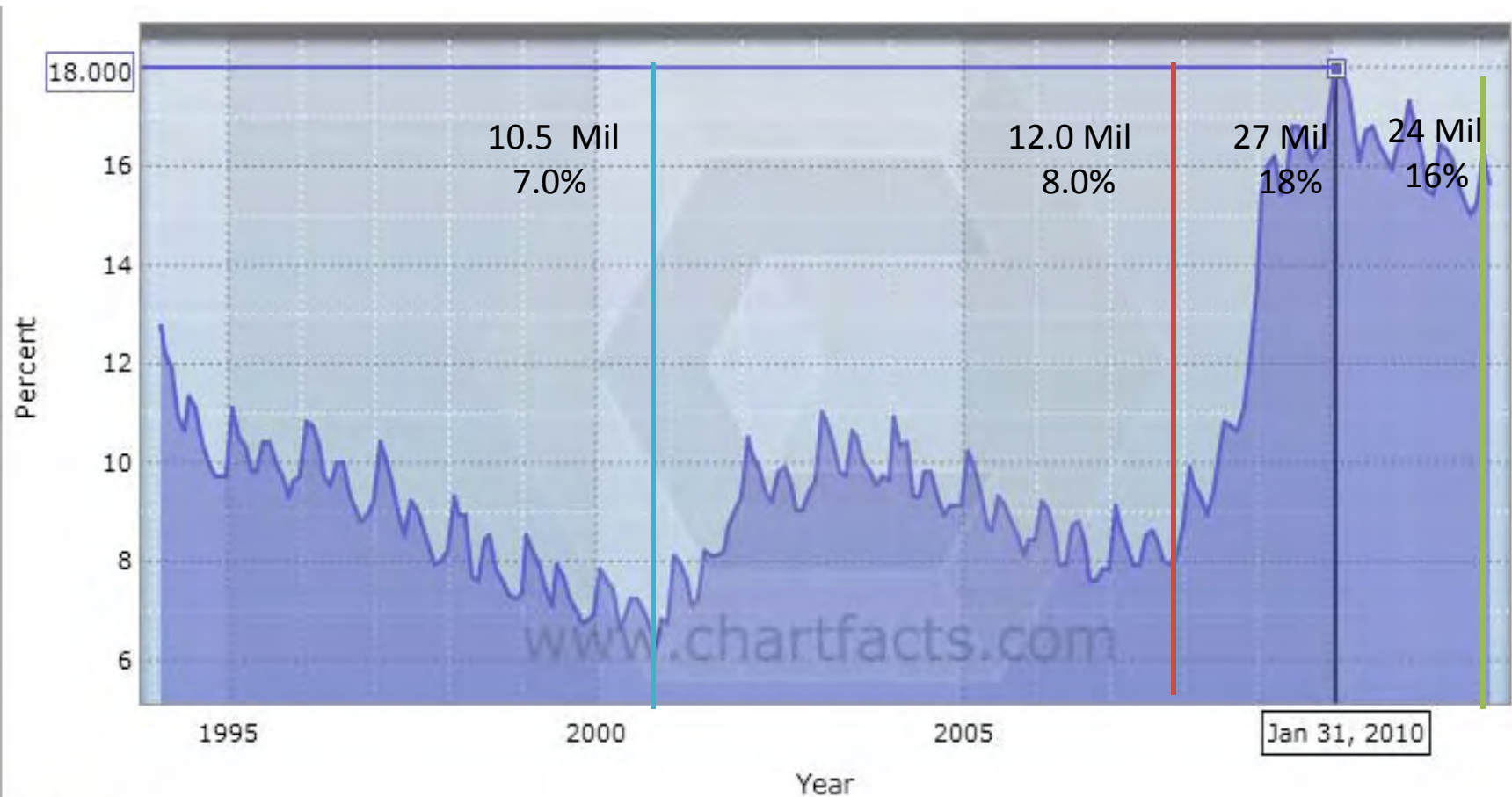
Rising Unemployment Rates Will Limit the Recovery



Rising Unemployment Rates Will Limit the Recovery



Total unemployed + marginal attached +employed part time for economic reasons



— Percent

Source: Federal Reserve economic database

How Bad Is It?: No Quick Recovery Likely

Climate Ripe for Additional Pressures

- Public & Private Debt–Banking Regs (380%-350% of GDP)
- Household debt/Income (133%-116%)
- Unemployment (10%-7.2%)
 - all categories (18%-16%)
 - food stamps (1 in 7)
 - jobs available (1 to 4)
 - wealth-income (1%-35%, 10%-48%)
- Energy –increasing prices (economic pressure)
- Interest rate-Exchange rate-labor (+’s & -’s)
- Political Stalemate (cut, spend, tax, regulate, invest)

Been There Before: High Debt and Unemployment, but Wealthiest Nation in the World by any Measure

- New Deal
- Marshall Plan
- Interstate highway system
- Space program
- Military Build Up
- Deregulations (banks), more regulations (environment), and lower taxes

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Suggestion from working session:

(1) Sufficient regulations to prevent – reckless lending again

- Too big to fail – has gotten bigger
- Low capital lending base
- Adequate regulations & enforcing regulators
- Dodd-Frank Bill (does it plug the holes?)

Suggestion from working session

(2) Tame Program Costs

- Social Security and military get 40% of Federal budget
- Medicare and Medicaid get 23% of Federal budget
- *Decrease rate of increase*
- *Provide support to unemployed during recovery*

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Suggestion from working session

(3) Serious examination of tax code

- Rebalance across households
- Direction of divergence in wealth and income
- Off-shore tax advantages
- Careful analytics on advantages and disadvantages

Suggestion from working session

(4)Balance macro's in determining winner and losers

Careful assessment with implication nationally for:

- lower interest rates
- Lower exchange rate
- energy price implications
- exchange rates between major competitors-china

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Suggestion from working session:

(5) Energy Priority program- investment for world leadership in energy production

- Well funded -- over next 20 years
- Energy Bill with spillover in related sectors
 - Provide stable, efficient, equitable energy supply meeting environmental guidelines
 - World dominance in energy research
- Energy efficient transportation – all sectors
- Energy efficient – housing and corporate
- Energy efficient water and sewage

Stimulates the Economy

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Optimistic that lessons learned from the past can serve as a basis for compromised middle ground

- **Option (1): Stay the Course**

Long, slow recovery until around 2018

- **Option (2): Find a Balance**

Accelerate the recovery

- Invest – like level support for energy bill
- Regulations/Deregulations – trade, banks, energy
- Budget balance-Cut & spend
- Tax code examination
- Balancing macro's- interest rates, exchange rates, trade

- **Analytics: 30-50 Year Footprint**

- **Cost Benefits for Longer Run Payback** – like models used in ag policy analysis

- Across all four sectors – 4-legged stool

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Major points

(1) Breaking loose: -Requires massive eco recovery plan

-Similar to several used by previous presidents

(2) Political Balance: -leaning too far in the chicken little-sky is falling direction

-wealthiest nation in the world by several measures

-can afford a well balance economic recovery program that stimulates all 4 sectors

-other things need tightening-

-China is using eco recovery plans to sustain employment, lesson learned from US policies

Understand the Problems:

First Step in Finding Answers

- Not in a recession
- Not in a depression
- Stagnant – not moving for several years
- Look back to look forward
- Stimulating territory for current opportunities
- Like to hear- your thoughts

-what can you do?

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